



**Bank of America**

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*8 July 97*

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Senior Vice President and  
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July 8, 1997

Director, Card Technology Division  
Financial Management Service  
U.S. Department of the Treasury  
Room 526, Liberty Center  
401 14th Street, S.W.  
Washington, D. C. 20227

Re: Electronic Benefits Transfer; 31 CFR 207  
RIN 1510-AA59

Dear Director:

Bank of America appreciates the opportunity to provide comments on the proposed rulemaking dealing with the Direct Federal Electronic Benefits Transfer (EBT) program to individuals who do not have an account at a financial institution. We hope these comments will be helpful in evaluating this proposed regulation, and we welcome the opportunity to provide additional comments as the process moves forward.

I. General Comments

The new EFT legislation -- EFT '99 (PL 104-134) -- has the potential to reduce the cost of making Federal payments and help promote electronic delivery of financial services more broadly. Electronic payments can play an important role in increasing access to financial services for those who are currently outside the scope of the traditional banking system. However, it is doubtful that EFT '99 alone will be successful in bringing the entire unbanked population into the mainstream financial community.

Bank of America is committed to providing banking services to underserved populations, including the "unbanked", profitably and at acceptable levels of risk. To this end, we are actively exploring various ways to improve access to financial services to the underserved. For example, we are currently working with community organizations such

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as the California Community Reinvestment Committee, community-based credit unions, social service agencies, and others, to develop educational programs and alternative methods of delivering financial services through community-based electronic banking sites which include ATMs, supermarkets, kiosks and PCs.

We are encouraged that Treasury and the Financial Management Service (FMS) recognize that not all recipients of Federal payments will qualify for, or will wish to establish, bank accounts and that this proposal for Direct Federal EBT has been developed as an alternative way to address the needs of these recipients. Although EBT can be a practical and workable alternative to paper checks for this population, the proposal raises some questions about how the program will be structured, including the rights and responsibilities of financial institutions designated as Financial Agents.

In order to evaluate the prospect of becoming a Financial Agent as set forth in the notice of proposed rulemaking (NPR), financial institutions like Bank of America need additional information about the specific duties of such agents and how the electronic delivery to recipients will be accomplished. For example, the proposed rule needs to be clarified regarding the responsibilities of Financial Agents with respect to Regulation E including financial liability, compliance and costs.

The product and contractual requirements envisioned by Treasury and FMS also need further development in order for financial institutions to accurately assess the risks and profit potential. While the initiative should result in substantial cost savings to Treasury, FMS and the Federal agencies, Direct Federal EBT will carry significant development, implementation and compliance costs not associated with the existing paper-based payment system. Financial Agents must be adequately compensated for these costs.

The fees that Financial Agents will have to charge are likely to meet with resistance, however, since there are existing low-cost ways to cash government checks in many communities. Because of the cost savings to be realized from Direct Federal EBT, we believe it is appropriate for these fees to be absorbed, at least in part, by the Federal Government instead of the payment recipients.

Finally, the proposal raises a number of infrastructure, customer service and training issues that could affect acceptability of the program by payment recipients and could make the January 1, 1999 implementation deadline difficult to meet.

## II. Specific Comments

### (a) The Invitation for Expression of Interest

More detailed information regarding the Invitation for Expression of Interest (IEI) would be useful for analyzing the role of the Financial Agent from a business perspective. Given the limited information currently available, the following are some of our initial comments and concerns:

1. Pricing and product structure -- In addition to recovering development and implementation costs, the economic viability of Federal Direct EBT accounts will depend on the Financial Agents' ability to establish appropriate pricing for the number and nature of transactions permitted and to accommodate other product features. Specifically:
  - Free transactions -- The number and type (e.g. withdrawals, balance inquiries, etc.) of free transactions, if any, and whether or not they will be permitted at POS terminals, ATMs, or both, will impact the cost of basic service and additional transaction fees.
  - Float -- Based on data from the Direct Payment Card Expansion Evaluation prepared for FMS by Citibank EBT services (the "Evaluation"), the potential to earn float on Direct Federal payments appears to be very limited. Revenue from float would fall far short of covering the costs of establishing and maintaining Direct Federal EBT accounts. These costs include operating expenses (ATM and POS support, item processing, statement preparation, overhead, etc.), reserves, regulatory compliance costs, customer service and training. Using the 3 days average float cited by FMS, the following example illustrates how limited this revenue opportunity is<sup>1</sup>:

\$750 (average Social Security Administration check amount)  
.055 (Funds invested at the Average Federal Funds rate of 5.5%)  
\$41.25 (Annual value of float per account *if held for an entire year*)

\$41.25/365 days = \$.113 per account per day  
\$.113 x 3 days = \$.34 total float revenue per account per month

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<sup>1</sup> According to FMS officials, during the Direct Payment Card pilot, funds remained in payment recipients' accounts for an average of 3 days. However, according to Debit Card News, during one 90 day period of the pilot, Citicorp earned only \$.19 per account per month of float -- significantly less than the \$.34 per account per month based on 3 days float. Debit Card News, June 18, 1997.

Note: This example does not consider any of the costs associated with operating a Direct Federal EBT account.

- Reclamation costs -- According to the Evaluation, the cost of reclamations on pilot accounts was approximately \$.14 per account per month. If the Financial Agent is liable for funds withdrawn after death under the Direct Federal EBT program, such costs would have to be factored in to pricing of these accounts.
  - Payment of account-related costs -- Federal payment recipients may be able to cash checks free of charge or for a nominal fee at some financial institutions, supermarkets and convenience stores. As a result, even the minimum fees necessary to support Direct Federal EBT will represent an increased expense to some payment recipients. In order for Federal Direct EBT to be an attractive alternative to paper checks, we believe that the Treasury and/or Federal agencies, who stand to benefit from reduced payment processing costs, must be willing to use some of these cost savings to cover some of the fees and other costs associated with Direct Federal EBT.
  - Other fee-related issues -- In addition to account-related charges, ATM owners may impose their own access charges. If a recipient's account balance is below the minimum ATM dispense level or the recipient would otherwise like to obtain an amount below this level, the transaction may have to be conducted at a POS terminal where a purchase may be required. These issues raise questions about how these costs should be allocated among payment recipients, Financial Agents and the Federal Government.
2. Definition of account -- the definition of a Direct Federal EBT "account" needs to be clarified. Although the supplemental information to the proposed rule draws three distinctions between Direct Deposit and EBT, it is not clear whether EBT accounts established by the Financial Agent in the name of Federal payment recipients will be considered true "accounts" as this term is generally used by financial institutions. For example, can the Financial Agent debit directly against the "account" (e.g. for service charges and reclamations costs)? Among other distinguishing characteristics, a true deposit "account" is classified as a liability on the financial institution's balance sheet reflecting the contractual obligation of the institution to the account holder.

In the context of existing EBT programs, no true deposit account is maintained for the beneficiary. Instead, a deposit account is maintained for the Federal agency and benefit recipients are issued cards which provide access to this account either directly, or via end of day settlement through a third party processor. In this context, the "account" is only a bookkeeping mechanism for the benefit recipient and the debit card issued to the recipient provides access to the funds. The increased legal and regulatory obligations associated with a true deposit account make this distinction a critical one for financial institutions contemplating acting as a Financial Agent.

3. Account termination -- The NPR specifies that Direct Federal EBT accounts can be closed only at the direction of FMS. We believe it will be difficult to find financial institutions willing to act as Financial Agents unless they have the ability to terminate or "freeze" the accounts of any Federal payment recipients who cause the Financial Agent a loss or otherwise abuse such accounts. If the ability to close accounts is limited to FMS, standards for such decisions must be clearly defined in the IEI and FMS may need to compensate the Financial Agent for any losses associated with accounts that can not be closed.
4. Additional Financial Agent duties -- The NPR also requires a Financial Agent to perform any duties which FMS determines are necessary or appropriate in connection with the Direct Federal EBT program. The NPR does not specify, but implies, that these duties will be determined at the sole discretion of FMS. Such duties may be technologically, financially or otherwise burdensome. However, the NPR provides no safeguard to limit, negotiate, or otherwise address the impact of any additional duties.
5. National versus regional or statewide Financial Agent contracts -- Whether Financial Agent contracts are awarded on a national, regional or statewide basis will involve a number of tradeoffs. Nationwide contracts have the potential to maximize economies of scale for developing an EBT system that can serve a nationwide population of payment recipients. However, such a structure could limit competition among potential service providers and limit innovation over time. Alternatively, regional contracts could provide financial institutions the opportunity to capitalize on regional operational or marketing strengths and could compliment existing regional state EBT alliances. Finally, statewide contracts could potentially be the best structure to facilitate Treasury and FMS' goal of combining Federal and state-administered benefits payments on a single card platform.

(b) Compliance With Regulation E and Related Costs

Proposed Section 207.3(a)(2) provides that the Financial Agent must comply with Regulation E, and the unbanked recipients will receive full Regulation E (Reg E) protection. Bank of America agrees that Federal payment recipients should be accorded appropriate consumer protections. However, we believe that the financial liability, compliance, and other costs associated with Reg E may be prohibitively high on Direct Federal EBT accounts. We believe that state EBT programs were granted a statutory exemption from Reg E in large part as a result of these high costs.

The major components of the costs associated with Reg E applicability are described below:

1. Liability for unauthorized use -- The most significant Reg E risk with respect to Direct Federal EBT is the potential financial liability for unauthorized use claims on a benefit recipient's account. Under the regulation, an institution must provisionally re-credit an account if a dispute is not resolved within 10 business days. If such provisional funds are subsequently withdrawn, the Financial Agent could suffer a loss. Although this risk is present with any account subject to Reg E, we believe the risk of loss on Direct Federal EBT accounts, which are likely to share certain characteristics, would be significantly higher than on other accounts. These higher risk characteristics include:
  - A customer base that is unfamiliar with bank accounts and banking processes. This inexperience also makes this segment particularly vulnerable to fraud operators;
  - Many customers on limited, fixed incomes -- less ability to absorb disputed transactions;
  - Relatively smaller balances -- less opportunity for the Financial Agent to recover provisional funds following dispute resolution;
  - A customer base for which any risk evaluation or qualification criteria is outside the Financial Agent's control.
2. Initial disclosures and periodic statements -- Reg E requires that disclosures be provided which outline consumer rights and protections. Reg E also requires that

periodic statements be provided for each monthly cycle in which an electronic fund transfer has occurred. This is a costly requirement, particularly given the fact that Direct Federal EBT accounts are expected to have very limited activity (e.g. withdrawals only, no check reconciliation). This requirement becomes even more challenging for recipients that do not have permanent mailing addresses.

3. Error resolution procedures -- It has been our experience that many less sophisticated customers, who are new to electronic banking services, have frequent questions about account activity. Since recipients who receive their Federal payments via Direct Federal EBT are, by definition "unbanked", we expect that much of this population would fall into this category. Unless such inquiries are limited to verifying a deposit and do not involve the assertion of an error, Reg E requires a written response.

As noted above, we believe that state EBT programs were granted a statutory exemption from Reg E largely because of the risks and associated costs outlined above. Since as much as 20% of the estimated 10 million unbanked federal payment recipients also receive State benefits, the applicability of Reg E to Federal payments but not State payments would be confusing to payment recipients and frustrate Treasury and FMS' goal to deliver both Federal and State benefits on one EBT card platform.

We believe that appropriate consumer protections for both Federal and State EBT programs can be provided outside the Reg E framework at significant cost savings. For example, a toll-free number could be established to handle customer inquiries. In addition, an abbreviated statement could be provided to Direct Federal EBT recipients at ATMs in lieu of a printed statement provided through the mail.

Whether or not some or all of Reg E is applicable, we believe that the compliance costs associated with Reg E or other consumer protections should either be factored into account pricing or covered by the Federal Agency as part of its contract with the Financial Agent. If, as specified by the NPR, the Financial Agent's role is limited to acting as agent for Treasury or other Federal agency, the Financial Agent should not have financial liability under Regulation E or bear the cost of compliance. These risks should be borne by Treasury or the Federal agency that has the "account" relationship with the payment recipient.

(c) FDIC Insurance Coverage

Proposed Section 207.3(a)(1) states that the account must be eligible for Federal deposit insurance (FDIC). Since the NPR specifies that Direct Federal EBT accounts are contractual arrangements between FMS and the Federal payment recipient, it is not clear how FDIC insurance coverage will be provided. Because the "account" relationship is between Treasury or other Federal agency and the payment recipient, we assume that these agencies will also be responsible for FDIC insurance coverage. Clarification on this point is important.

(d) Customer Service and Training

Because Direct Federal EBT recipients are, by definition, "unbanked," we anticipate that such accounts will require specialized customer service handling, at least initially. Many payment recipients are likely to be elderly social security recipients who, in addition to being "unbanked," may be unfamiliar with electronic access devices like ATMs and POS terminals and may be distrustful of such technologies. There are also likely to be significant language, educational, and cultural hurdles that will require extensive training and customer service handling.

According to the Evaluation, training was not found to be particularly troublesome. However, we expect different results under mandatory Direct Federal EBT for several reasons: (1) voluntary participants generally accept new products and procedures more readily than the population at large; (2) the effectiveness of training for non-English speaking participants can not be measured since the Direct Payment Card pilot provided only limited marketing materials in languages other than English, and; (3) the Evaluation results may not be predictive of the larger population since only 3% of the recipients participated in the pilot.

Although the language, educational and cultural hurdles can be overcome, the training and customer service required will involve considerable time and expense. Although we believe any financial institution acting as a Financial Agent can play an important role in providing this training and ongoing customer service, the Treasury and Federal Agencies should bear some of this cost.



(e) Direct Deposit Too

Although the NPR addresses Direct Federal EBT accounts only, the proposal also raises questions about the marketability and economic viability of the Direct Deposit Too (DDII) account. For example, if some of the "unbanked" do not currently have bank accounts because they do not like dealing with banks or do not want a conventional bank account, we question why such recipients would choose a DDII account over an Direct Federal EBT account.

As true deposit accounts, DDII would carry most of the risks associated with a conventional deposit account. Such risks could be reduced, but not eliminated, by limiting product features. Yet creating such limits could themselves produce significant developmental and operational expense. For example, many banks may need to develop a separate deposit system to support an all electronic deposit account. In light of the Direct Federal EBT proposal for those who can't qualify for or don't want to establish a conventional bank account, we question the viability of the DDII alternative.

Such accounts would have to be significantly less expensive for financial institutions to offer than conventional accounts. Although limited features should reduce some operating costs, these cost savings could be more than offset by other account characteristics and account holder behavior. As noted above, we expect such accounts to maintain relatively low account balances and require a high degree of training and customer service. To overcome these characteristics, financial institutions must be able to reduce the costs associated with these accounts in other ways. In addition, responsibility and liability under Reg E must be limited.

III. Conclusion

EBT can play an important role in reducing government expenses and providing a convenient and safe method for recipients to receive payments. EBT can also improve access to financial services for those currently outside the scope of the traditional banking system. Financial institutions can help to achieve these goals by acting as Financial Agents for Treasury. However, financial institutions should not be expected to bear all the costs to develop, implement and maintain the requisite delivery infrastructure. Thank

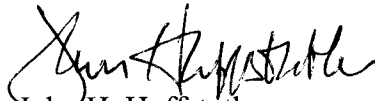
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you for this opportunity to provide our comments. We would be pleased to answer any questions or discuss any of these issues in greater detail. Please feel free to call me at (415) 622-8565 or Brenda Yost at (415) 622-3767. We look forward to working with you as the process moves forward.

Very truly yours,

A handwritten signature in dark ink, appearing to read "John H. Huffstutler", written in a cursive style.

John H. Huffstutler

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